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SUBJECT: Canadian ABCP Market Under Bankruptcy Protection

REF: (A) Toronto 66 (B) 07 Toronto 430 (C) 07 Toronto 422

Sensitive But Unclassified - Please protect accordingly.

¶1. (SBU) Summary: On March 17, an Ontario Superior Court Judge agreed to convert 20 Canadian trusts, which had issued C$33 billion in non-bank sponsored asset-backed commercial paper (ABCP), into corporations and to protect them from notices, lawsuits, and other claims under the Companies' Creditors Arrangement Act (CCAA) until at least April 16. To date, it is unclear where the assets underlying Canada's ABCP physically lie -- whether in Canada or the U.S. Analysts estimate the current average value of non-bank ABCP at about 60% of their pre-August 2007 financial crisis value of C$33 billion. The expert committee working to restructure the non-bank ABCP market has not yet unveiled detailed terms of its restructuring plan designed to convert the short-term asset-backed notes into longer-term bonds, though investors will reportedly be asked to vote on the plan by the end of April. Canadian investors, protected by the early freeze of the non-bank ABCP market and a commodity-heavy national stock exchange (TSX), have so far been spared some of the visible turbulence of the U.S. financial markets, but even without a sub-prime mortgage crisis of their own, some significant Canadian investors (including federal and provincial pension funds) may face stormy seas when the non-bank ABCP market is unfrozen. End Summary.

Bankruptcy Protection

¶2. (SBU) The non-bank ABCP market has been frozen since last August. On March 17, in an unprecedented move, an Ontario Superior Court Judge agreed to convert 20 Canadian trusts, which had issued C$33 billion in non-bank sponsored (third party) asset-backed commercial paper (ABCP), into corporations and to protect them from notices, lawsuits, and other potential claims under the Companies' Creditors Arrangement Act (CCAA) until at least April 16. The court protection plan reportedly has the backing of Bank of Canada governor Mark Carney and federal Finance Minister Jim Flaherty.

Underlying ABCP Assets Remain Undefined

¶3. (SBU) The ABCP marketplace has remained opaque because Canadian federal or provincial governments impose few transparency requirements on trusts, which originally issued the investment vehicles, or on the non-publicly traded corporations into which these trusts have just been converted. To date, it is unclear what specific assets underlie the non-bank or the bank-backed ABCP, beyond the fact that they include mortgages (some subprime), car

loans, and credit card debt, making it difficult to assess what portion of those pooled assets is physically located in Canada, the U.S., or some other foreign country.

¶4. (SBU) Analysts estimate the current average value of non-bank ABCP at about 60% of the pre-August 2007 financial crisis value of C$33 billion. The 20 newly-formed corporations have been downgraded by Canada's Dominion Bond Rating Service (DBRS) to a D rating. The Crawford Committee of major investors (led by Toronto lawyer Purdy Crawford) who have sought a consensual solution to the crisis triggered by the subprime mortgage meltdown since last August, has been unable to obtain a second rating by another rating agency. However, the underlying assets are considered to still have a better than D rating. The bank-backed ABCP, which continues to freely trade and is still fully backed by Canadian financial institutions, is reportedly trading at 80% of its C$85 billion pre-August value.

Market Restructuring Plan Coming Together

¶5. (SBU) On March 17, Toronto Dominion Bank, which had previously refused to participate in the market restructuring (ref (A)), announced that it agreed to back the C$14 billion back-up credit facility for an unspecified amount. The Crawford committee, which has been working to restructure the third party ABCP market since it was frozen in August, has not yet unveiled detailed terms of its restructuring plan designed to convert the short-term asset-backed notes into longer-term bonds. In December 2007, the committee announced a restructuring framework that calls for value preservation and market transparency of the underlying assets to promote liquidity and market confidence in the new notes or bonds that will be issued. The bonds, which will mature in 7 to 10 years,

are intended to allow investors to recoup much of their money (ref (A)). If the restructuring works, which is the biggest in Canadian history, Canada reportedly would be the first country to complete a successful market restructuring without a government bailout.

¶6. (SBU) Under the protection of CCAA, the Crawford Committee will call a meeting of ABCP investors (note holders of the affected trusts) to approve the committee's restructuring plan. The restructuring plan will be mailed out to all note holders and they will be given approximately 30 days to vote on the plan. The plan must be approved by a majority of note holders, regardless of the size of their holdings, as well as by note holders representing at least 66 and 2/3% of the total aggregate principal amount. Under court protection, investors are prohibited from suing any financial institution that sold the frozen short-term notes. Many individual investors reportedly hold non-bank ABCP notes; C$21 billion is reportedly held by Canada's major financial institutions and federal and provincial pension funds.

Investors Are Concerned

¶7. (SBU) Critical independent investors are worried that their money, which was initially invested in ABCP for short periods of time (e.g. three months), will be tied up for too long in the restructured bonds, and that they will still lose much of their principal investment. The same investors are concerned that Canadian banks may eventually face liquidity crises which could prompt them to back out of guaranteeing the market. Market analysts have expressed concern that the crisis may ultimately spread to the C$85 billion Canadian bank-sponsored ABCP market. Canadian Imperial Bank of Commerce (CIBC) and Bank of Montreal (BMO) could face further billion-dollar write-downs related to investments in U.S. subprime mortgages and non-bank ABCP (ref (A)), but analysts believe Canada's large banks are basically healthy because they derive most of their profits from old-fashioned retail banking, and did not issue subprime mortgages in Canada.

Spill-over from Bear Stearns?

¶8. (SBU) Over the past four years, Bear Stearns issued C$2.65 billion in Maple bonds in Canada, and investors are worried about their risk level (Note: Maple bonds are Canadian-dollar-denominated bonds issued in Canada by foreign companies. End Note). Bear Stearns offered 11 issues of fixed- and floating-rate Canadian dollar-denominated debt, which it sold through the brokerage arms of the Bank of Nova Scotia and Royal Bank of Canada (RBC). Vancouver's Phillips Hager & North Investment Management, which RBC is in the process of taking over in a C$1.36 billion deal, is reportedly the largest holder of several of the Bear Stearns Maple bond issues. As the new owner of Bear Stearns, JP Morgan will reportedly guarantee the Maple bonds. Last December, JP Morgan Chase also said it would make up any short-fall in the C$14 billion line of credit being put together by the Crawford Committee. It is still unclear to investors here whether JP Morgan Chase's weekend acquisition of Bear Stearns could reduce the former's liquidity enough to endanger its agreement to back the Canadian non-bank ABCP market restructuring.

¶9. (SBU) Comment: Canadian investors, protected by the early freeze of the non-bank ABCP market and a commodity-heavy national stock exchange (TSX), have so far been spared some of the visible turbulence of the U.S. financial markets, but even without a sub-prime mortgage crisis of their own, some significant Canadian investors (including pension funds) may face stormy seas when the non-bank ABCP market is unfrozen. Canadian banks remain relatively healthy - healthy enough that Royal Bank of Canada (RBC) was rumored to be a possible buyer for Bear Stearns. We believe it will be difficult for the Canadian federal government to resist investor calls for Parliamentary hearings on the non-bank ABCP market in the coming weeks. It is not clear whether the federal government will require additional reporting and transparency requirements from trusts or non-publicly traded corporations. End Comment.

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